



Anneals of Wilfred and Gertrude Winkenbach. et al.

against proposed assessments of additional personal income tax in the amounts of \$3,088.47, \$3,385.27, \$1,098.03, and \$762.57 for the years 1963, 1965, 1966 and 1967, respectively; pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of W. H. Winkenbach, Inc., for refund of franchise tax in the amounts of \$691.31 and \$201.20 for the income years ended July 31, 1964, and July 31, 1966, respectively; and pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Santa Fe Homes, Inc., for refund of franchise tax in the amounts of \$1,534.18, \$2,272.08, \$823.48, and \$595.63 for the income years 1963, 1965, 1966 and 1967, respectively.

The primary issue for determination is whether respondent properly attributed the income of the corporate appellants to the individual appellants in accordance with a federal determination. If we conclude that the income was properly attributed to the individual appellants, we must then determine whether the corporate appellants are entitled to a refund, or, whether the tax paid by the corporations should be offset against the amounts owed by the individual appellants.

Wilfred Winkenbach (hereafter appellant) and Lloyd F. Noonan **were two of the four general partners in Superior Tile Company of Oakland.** Superior Tile Company was primarily engaged in the tile business. In 1959, after consulting with their attorney and accountant, the partners formed a limited partnership, Superior Tile Company of Santa Clara. Appellant and Noonan were general partners, each having a two percent partnership interest. The partnership had four limited partners, all of whom were corporations. Appellant was the sole shareholder of Santa Fe Homes, Inc., and Noonan was the sole shareholder of L. F. Noonan, Inc. Each of these corporations held a 23 percent limited partnership interest in the Santa Clara partnership. The remaining 50 percent was owned by the other two corporations in equal shares.

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In 1961, the four partners formed a second limited partnership, Superior Tile Company of Sacramento. The ownership structure of the Sacramento partnership was similar to that of the Santa Clara partnership. Appellant and Noonan were general partners each having a two percent partnership interest. The Sacramento partnership also had four limited partners, all of whom were corporations. Appellant was the sole shareholder of W. H. Winkenbach, Inc. , while Noonan was the sole shareholder of Linda Lloyd, Inc. Each of these corporations held a 23 percent limited partnership interest in the Sacramento partnership. The remaining 50 percent was owned by the other two corporations in equal shares.

The ostensible purpose of this business arrangement was to improve the business position of Superior Tile Company of Oakland and its subsidiary operations with regard to inventory and financing in the tile installation field. However, the Internal Revenue Service challenged this elaborate structure, maintaining that the corporations should not be recognized as entities for federal tax purposes. The issue was ultimately litigated in the United States Tax Court and resulted in a decision adverse to the individual taxpayers. (Lloyd F. Noonan et al. , 52 T. C. 907, aff'd, 451 F. 2d 992.) The result of this decision was that the taxable income originally received and reported by the corporations was taxed to the corporations' sole shareholders in their individual capacities.

As a result of the outcome of the federal audit and subsequent litigation, respondent attributed to appellant his proportionate share of the income of Santa Fe Homes, Inc. and W. H. Winkenbach, Inc. as personal income. This transfer of income resulted in deficiencies of personal income tax for the years 1963, 1965, 1966 and 1967. Appellant protested these assessments but the protest was denied. Appellant also filed claims for refund on behalf of Santa Fe Homes, Inc. and W. H. Winkenbach, Inc. However, these claims were not filed until March 15, 1973, after the statute of limitations had expired. Thus, the state not only has retained the tax paid by the corporations but also asserts its right to collect a tax from the individual appellant on the same income.

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Appellant challenges respondent's action on two alternative theories. First, appellant maintains that the corporate income was improperly attributed to him. Alternatively, appellant argues that if it is determined that the corporate income was properly attributed to him, the tax paid by the corporations should be refunded or offset against the amount of the tax owed by him in his individual capacity.

We have no difficulty in deciding the first issue in favor of respondent. Section 18451 of the Revenue and Taxation Code provides that where there has been a federal tax determination involving income or deductions the taxpayer shall concede the accuracy of the determination or bear the burden of showing where it is incorrect. As indicated above, the Tax Court found against appellant on the issue of whether the corporations were separate viable entities for tax purposes. In reaching its decision the court stated:

In the instant case, at least insofar as the years here in issue are concerned, the bones of the corporations were without flesh. The record is devoid of any evidence that the corporations engaged in any substantive business purpose. They were "mere paper corporations that existed in form only for the purpose of obtaining the tax benefits available by splitting the income" of partnerships in which they had limited interests. [Citation.] (52 T. C. at 910.)

It is true, as appellant points out, that the findings of the Tax Court are limited to 1963, the only year in issue in that proceeding. In line with this limited holding, appellant argues that in the years after 1963 the corporations did engage in other business activities which would justify their existence as separate taxable entities. However, other than by uncorroborated assertions, appellant has failed to offer any evidence of specific business activities that the corporations engaged in after 1963. Therefore, in the absence of any persuasive evidence to the contrary, we find the Tax Court decision highly persuasive of the result that should be reached in this proceeding. Accordingly, we conclude that respondent properly attributed the corporate income to appellant in his individual capacity in accordance with the federal determination.

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Since we have concluded that the income was properly attributed to the appellant in his individual capacity, we must now determine whether the corporate appellants are entitled to a refund, or, whether the tax paid by the corporations should be offset against the amounts owed by the individual appellants. Initially, it is readily apparent that the claims for refund filed on behalf of the corporate appellants were not timely. (Rev. & Tax. Code, § 19053.) Appellant does not contend otherwise.

California law does provide for an offset against a tax deficiency of overpayments of tax where a refund is barred by the expiration of the statute of limitations. Section 19053.9 of the Revenue and Taxation Code applies to overpayments due a taxpayer which result from a transfer of items of income or deductions to or from another year for the same taxpayer or a related taxpayer described in section 18691. 1. The situation under review does involve a transfer of funds in each of the years in issue from one taxpayer to another--from corporations to an individual. However, a corporation and an individual are not related taxpayers within the definitions set forth in section 18691.1. Therefore, appellant cannot qualify for relief under section 19053.9 of the Revenue and Taxation Code.

There is, however, one additional theory under which appellant may obtain relief. That theory involves the doctrine of equitable recoupment.

The doctrine of equitable recoupment is based primarily on two decisions of the United States Supreme Court. (Bull v. United States, 295 U. S. 247 [79 L. Ed. 1421]; Stone v. White, 301 U. S. 532 [81 L. Ed. 12651].)

In Bull the Court held that equitable relief in the nature of recoupment was available notwithstanding the fact that an independent action for a refund was barred by the statute of limitations. In that case the government taxed a single fund of money twice--once as corpus and again as income. The Court allowed recovery by the executors of the taxpayer's estate even though an independent proceeding for a refund was barred by the statute of limitations. The basis for the Court's holding was that it would be unjust to tax the same transaction twice on inconsistent theories and also to deny recovery of the incorrect tax.

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In Stone the government was the beneficiary of equitable recoupment . The Court refused to allow a claim for refund on behalf of trustees who had paid taxes which should have been paid' by the trust beneficiary where the statute of limitations barred any action by the government to collect the tax from the beneficiary.

It is correct, as respondent has pointed out, that the potentially broad remedy of equitable recoupment has been narrowed. Thus, the doctrine has been limited to situations where a single transaction or taxable event has been taxed twice to the same taxpayer on inconsistent legal theories. (Rothensies v. Electric Storage Battery Co. , 329 U. S. 296 [91 L. Ed. 296].) In such a situation, what was mistakenly paid may be recouped against what is correctly due. In effect, the doctrine of equitable recoupment is really a case law exception to the statute of limitations where its application would work a palpable injustice. (Pond's Extract Co. v. United States, 134 F. Supp. 476.)

Before we can consider whether the doctrine of equitable recoupment is applicable to the facts presented in this appeal, however, a preliminary question must be resolved. In prior decisions of this board where the factual situations did not warrant 'an application of equitable recoupment, we have expressed our concern with whether this board had jurisdiction to apply that doctrine. (See, e. g. , Appeal of Frank and Elsie M. Bartlett, Cal. St. Bd. of Equal., May 15, 1974; Appeal of Estate of Zebulon P. Owings, Deceased, and Mabel J. Owings, Cal. St. Bd. of Equal., Jan. 7, 1975.) Our concern was generated primarily by the fact that this board is not a court of general jurisdiction.

At one time, the California Supreme Court frequently denied that any statewide agency of statutory origin^{1/} could exercise

^{1/} Although this board's origin may be traced to article XIII of the California Constitution, its authority under the Personal Income Tax Law and the Bank and Corporation Tax Law is statutory. State agencies created in the Constitution, or delegated power by the Constitution other than the particular power under consideration, do not benefit from their constitutional status. (Cf. Tringham v. State Board of Education, 50 Cal. 2d 507 [326 P.2d 850]; see generally, Kleps, Certiorarified Mandamus Reviewed: The Courts and California Administrative Decisions 1949-1959, 12 Stan. L. Rev. 554, 564 (1960).)

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any quasi-judicial functions when dealing with vested rights. (See, e.g., Laisne v. California State Board of Optometry, 19 Cal. 2d 831, 835, 862-863 [123 P.2d 457]; Whitten v. California State Board of Optometry, 8 Cal. 2d 444 [65 P.2d 1296].) These cases were based on the theory that the Legislature could not, consistently with the state Constitution, grant these agencies judicial power. However, this concept grew out of the court's early procedural difficulties in this area and should not be extended unnecessarily. (See generally, Kleps, Certiorarified Mandamus Reviewed: The Courts and California Administrative Decisions 1940-1959, 12 Stan. L. Rev. 554 (1960).) More recent decisions have recognized that such agencies exercise "quasi-judicial", "adjudicatory", or "adjudicating" power, acknowledging that the only real difference exists in the matter of judicial review. (See, e.g., DiGenova v. State Board of Education, 45 Cal. 2d 255 [288 P.2d 862]; Temescal Water Co. v. Department of Public Works, 44 Cal. 2d 90 [280 P.2d 1]; Andrews v. State Board of Registration, 123 Cal. App. 2d 685 [267 P.2d 352]; Boren v. State Personnel Board, 37 Cal. 2d 634, 637-38 [234 P.2d 981] (dictum).)

Whether' this board performs an administrative, quasi-judicial or adjudicatory function in executing its statutory directive to "hear and determine the appeal", it is our opinion that we are bound to apply judicially accepted doctrines. The difference, once regarded as basic, between the method of resolving legal defenses and equitable defenses, no longer exists; independent suits are no longer necessary to establish equitable rights. (Cf. Bankers Indemnity Insurance Co. v. Industrial Accident Commission, 4 Cal. 2d 89, 94-98 [47 P.2d 719].) Accordingly, whenever possible, all matters should be disposed of before this board in order to assure a prompt resolution of the competing claims of the parties without requiring unnecessary litigation and expense.

Concern with whether this board could apply the doctrine of equitable recoupment has also been generated by those cases which have held that the United States Tax Court

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lacks jurisdiction to apply equitable recoupment. ^{2/} (See, e. g. , Commissioner v. Gooch Milling & Elevator Co., 320 U. S. 418 [88 L. Ed. 139]; Estate of Mabel C. Van Winkle, 51 T. C. 994, 999-1000; Elizabeth Lewis Saigh, 36 T. C. 395, 427.) However, an examination of Gooch reveals that the decision turned on the peculiar nature of the Tax Court's jurisdiction. The holding of the court in Gooch was that to allow such an offset would necessarily involve a determination by the Tax Court of an overpayment in a prior year which was not before the court. In order to appreciate the thrust of the Gooch decision and those cases following it, a brief examination of the Tax Court's jurisdiction is appropriate.

The Tax Court is a statutory body of limited jurisdiction. Before the Tax Court can assert jurisdiction, the Internal Revenue Service must first issue a deficiency notice. If it is appealed, the Tax Court has exclusive jurisdiction to determine the correct amount of liability for the year, or years, in question. The Tax Court is empowered to determine the correct amount of the tax and may determine that a deficiency or overpayment exists. The Tax Court does not otherwise have jurisdiction over claims for refund. (See generally, Int. Rev. Code of 1954, §§ 6211-6214, 6512.)

^{2/} While there is language in some cases to the effect that the Tax Court lacks jurisdiction to apply general equitable principles, this overly broad assertion is not supported by case law. For example, the doctrine of equitable estoppel has been applied frequently by the Tax Court and by the United States courts of appeals on the review of Tax Court decisions. (See, e.g. , Aurore B. Benoit, 25 T. C. 656, 668-69; Lucas v. Hunt, 45 F. 2d 781.) Additionally, in appropriate cases, the Tax Court has had little difficulty in applying the doctrine of collateral estoppel. (See, e.g., John W. Amos, 13 T. C. 50; Arctic Ice Cream Co., 43 T. C. 68; see also Fairmont Aluminum Co. v. Commissioner, 222 F. 2d 622, 627.) This distinction may be academic now. Since the Tax Reform Act of 1969 amended section 7441 of the Internal Revenue Code to provide that the Tax Court is a "court of record" established "under article I of the Constitution of the United States", it has been suggested that the Tax Court can now exercise equitable power within the confines of its statutory jurisdiction. (See generally, Shores, Article I Status For-the Tax Court, 25 Tax Lawyer 335 (1972).)

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Thus, if the taxpayer has appealed concerning an income tax for one year and there is, in fact, a deficiency for that year, but there is no notice of deficiency for any other year, the Tax Court does not have jurisdiction of any other year and cannot set off or permit recoupment of a barred overpayment for another year against the deficiency. However, if the taxpayer appeals concerning asserted deficiencies for two or more years so that the Tax Court has jurisdiction of the controversies for those years, and there has been an overpayment for one of those years, the Tax Court has jurisdiction to determine the overpayment as well as a deficiency so that the taxpayer may, in effect, gain a setoff or recoupment. (See generally, Annot., 12 A. L. R. 2d 815, 834; cf. Louis Scarlata, T. C. Memo., May 23, 1951.)

Since it is this latter situation that we are concerned with in the instant case--all the years in question are before us--coupled with the fact that this board, unlike the Tax Court, does have jurisdiction over claims for refund^{3/} (Rev. & Tax. Code, §§ 19059 & 26077) as well as proposed assessments (Rev. & Tax. Code, §§ 18594 & 25667) we find cases such as Gooch, supra, distinguishable..

For the reasons that we have discussed above, we do not feel prevented by jurisdictional constraints from applying the doctrine of equitable recoupment in an appropriate situation.

We must, therefore, determine whether the facts presented in this appeal warrant an application of equitable recoupment. An underlying inquiry in determining the applicability of the doctrine in favor of the taxpayer is whether the government

^{3/} A proceeding for the refund of taxes is equitable in nature and subject to equitable defenses which must conform to equitable standards. (Stone v. White, supra, 301 U. S. at 534, 537.)

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has received monies which in equity and good conscience belong to the taxpayer. (Bull v. United States, supra, 295 U. S. at 260; Boyle v. United States, 355 F. 2d 233; United States v. Herring, 240 F. 2d 225, 228.)

As we have noted above, the doctrine is limited to a situation where a fund of money arising from the same taxable transaction or event has been taxed twice on inconsistent legal theories to the same taxpayer. We have no difficulty with the first two requirements. A fund of money arising from the same taxable event has been taxed twice on inconsistent legal theories. Income earned by the corporations was first taxed to the corporations on the theory that it was corporate income. Thereafter, respondent proposed, once again, to tax the same income to the individual taxpayer on the theory that it was personal income.

Respondent argues that the third requirement--the same taxpayer must be involved--is not satisfied. It is respondent's somewhat incongruous position that, for the purpose of applying the doctrine of equitable recoupment, the corporations are separate and distinct taxpayers from the individual appellant. Therefore, respondent concludes that although tax was erroneously paid by the corporations it should, nevertheless, be retained by the state. This same contention was advanced by the federal government in a strikingly similar case involving a corporation and its sole shareholder. (Hufbauer v. United States, 297 F. Supp. 247.) In resolving the issue in favor of the taxpayer, the court stated:

There is no clear definition of the proper relationship in the cases. On the one hand, the leading cases, Bull, Stone and Boyle, supra, all involve the same taxpayer (Bull) or taxpayers related in a "representative" way (Stone and Boyle). On the other hand the Court in Rothensies, in discussing the Stone case, chose to point out that the recovery for the trustees would inure to the benefit of the beneficiary. In light of the established rule that trustees and beneficiaries of a trust are separate taxable entities, as are a corporation and its sole shareholder, and of the established rule that a sole shareholder owes

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fiduciary duties to his corporation in certain circumstances analogous to that owed a beneficiary by a trustee, the better view would seem to be that if the requirement of identity is satisfied where the relationship between the taxpayers is that of trustee-beneficiary, it is also satisfied where a corporation-sole stockholder relationship exists, as in this case. In each instance, the benefit to one taxpayer inures to the benefit of the other taxpayer only. (297 F. Supp. at 250-51.)

In line with Hufbauer; supra, we conclude that there is substantial identity among the taxpayers in the instant appeal.

Respondent has suggested that recoupment should not be permitted under the circumstances of this case since the situation from which relief is sought was created by appellant's lack of diligence in seeking a refund of the corporate overpayments. However, this identical contention was advanced by the federal government in United States v. Bowcut, 287 F. 2d 654 and was resolved in the taxpayer's favor!-court, in Bowcut, supra at 657, stated:

The facts in the case before us are similar to those in Bull v. United States, and in our view that case is controlling upon this point. In that case the taxpayer had as much opportunity as had the taxpayer here to enforce a legal right to refund, and equitable relief was not denied for this reason. It is apparently not the diligence of the taxpayer as to his legal rights which controls, but rather the inequity of holding that, while the government's rights under a transaction continue unimpaired, its adversary's rights thereunder are barred by limitations.

(See also, Pond's Extract Co. v. United States, supra, at 480.)

For the reasons set out above, we believe that the doctrine of equitable recoupment is applicable to the instant situation. Accordingly, the tax erroneously paid by the corporations should be offset against the amounts properly owed by the individual appellants.

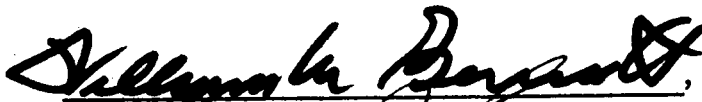
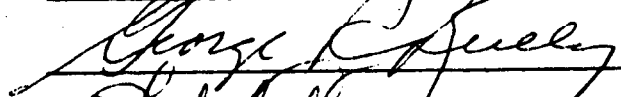
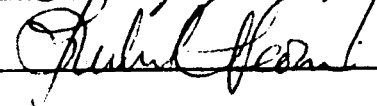
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ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Wilfred and Gertrude Winkenbach against proposed assessments of additional personal income tax in the amounts of \$3,088.47, \$3,385.27, \$1,098.03, and \$762.57 for the years 1963, 1965, 1966 and 1967, respectively; and pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of W. H. Winkenbach, Inc., for refund of franchise tax in the amounts of \$691.31 and \$201.20 for the income years ended July 31, 1964, and July 31, 1966, respectively, and in denying the claims of Santa Fe Homes, Inc., for refund of franchise tax in the amounts of \$1,534.18, \$2,272.08, \$823.48 and \$595.63 for the income years 1963, 1965, 1966 and 1967, respectively, be and the same is hereby modified in accordance with the opinion of the board. In all other respects, the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 16th day of December, 1975, by the State Board of Equalization.

, Chairman
, Member
, Member
_____, Member
_____, Member

ATTEST: , Executive Secretary